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ABSTRACT

Front and center in 2001 domestic policy debates is President George W. Bush's proposed tax relief plan. The U.S. federal tax is a progressive tax code, predicated on the assumption that "people who are most able to pay should pay the most." A progressive tax system makes an individual's tax bill increase faster than his/her income. The lesson contains an article, "The Effect of Progressive Tax Codes" (Bill Ahern), that considers the effect of progressive tax codes. The lesson plan then poses questions about President Bush's proposal, using Ahern's article as a basis, and provides several activities in calculating taxes. The lesson provides questions for class discussion and gives answers for teacher reference. (BT)

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Tax Cut Legislation: What's Fair?

If you've listened to radio and TV news or read the newspaper lately, you know that front and center in domestic policy debates is President Bush's proposed tax relief plan. Supporters hail it as just the shot in the arm the nation needs; opponents label it an unfair, sweetheart deal for the rich at the expense of the poor; some assert that it's no tax cut at all; and still others believe that the wealthiest wage earners get less than they deserve. How do you sort through the rhetoric and form an opinion of your own?

Let's look, as an example, at the tax bill of a single person - like you - as you work or go to college after high school and gradually earn a larger income.

Suppose that, until you're about 22, you earn $5000/year. At 22, you get a better job and start earning $25,000/year. Look at how your tax bill will increase under a progressive tax code:

Progressive taxation		
income	$5000	$25,000
tax rate (%)	10%	15%
$ taxes paid	$500	$3750

The United States Federal income tax is a progressive tax code, and is predicated on the assumption that "people who are most able to pay should pay the most." A progressive system makes your tax bill increase faster than your income. In the example, above, the progressive rate increase would cause you to pay $1250 more than if the rate was constant, over all levels of income.

The first step in understanding the never-ending discussion of taxation is understanding the impacts of our progressive tax structure.

Following is an article from the Heartland.org website on the effect of Progressive tax codes.

March/April 2001: Taxes

The Effect of Progressive Tax Codes

By Bill Ahern

Bill Ahern is communications director for the Tax Foundation.

Arguments over tax plans are really arguments about how "progressive" our tax system is. Our current federal income tax code has five rates: 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent. This is a progressive structure, meaning the more you earn, the more you pay *as a percentage of your income.*

To evaluate whether a tax-cut plan makes the current code more or less progressive, the question to ask is similar: How would the plan change the percentage of income taken in taxes from each "income group," this year and in the future?

When the rates are left unchanged over several years, tax burdens rise by themselves because people earn more and find themselves paying higher rates. As a result, tax collections rise at a faster rate than taxpayers' income. So while the nation's income has increased at a 6.2 percent clip over the past decade, income tax collections have grown by 7.9 percent.

Any nation with a progressive tax code, then, must enact periodic tax cuts unless it wants the government to collect and spend an ever-larger fraction of the people's income.

In addition to causing these "autopilot" tax increases, progressivity creates much of the tax code's complexity. Nevertheless, the income tax code has been progressive since its inception, and during last year's Presidential campaign both major party candidates proposed plans that would increase this progressivity. ....

As Bill Ahern explained in his article, the real question to ask about the President's proposal is: How would the plan change the percentage of income taken in taxes from each 'income group,' this year and in the future?"

Try to answer Mr. Ahern's question, using the income profile we proposed for you earlier in the article and the following summary of the major provisions of the Bush tax proposal:

Replaces the current marginal income tax rates of 15, 28, 31, 36, and 39.6 percent with a simplified rate structure of 10, 15, 25, and 33 percent.

Note that the Bush proposal divides the lowest income category into 2 new categories, and combines the two middle categories and two highest categories into one each.

The table below illustrates the rates under the current tax code and the proposed tax relief plan of President Bush actual final rates may vary depending on the House and Senate negotiations).

Given the likely pattern of your income over the next 5 or 6 years, which code would you favor?

Tax Rates by 2001 Taxable Income*

Courtesy of the White House

Current Code			**Bush Plan****		
Single			Single		
$0	$27,050	15%	$0	$6,000	10%
$27,050	$65,550	28%	$6,000	$27,050	15%
$65,550	$136,750	31%	$27,050	$136,750	25%
$136,750	$297,350	36%	$136,750	--	33%
$297,350	--	39.6%			

Married- Joint Filing			Married- Joint Filing		
$0	$45,200	15%	$0	$12,000	10%
$45,200	$109,250	28%	$12,000	$45,200	15%
$109,250	$166,500	31%	$45,200	$166,500	25%
$166,500	$297,350	36%	$166,500	--	33%
$297,350	--	39.6%			

*Taxable income is income less deductions and personal exemptions.

**Rate schedule assumes tax plan is fully phased in.

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You can see that the percentage decrease in the tax rate drops for both single and married tax payers under President Bush's plan.

When calculating progressive tax liability, you must figure the tax on different segments of income and then sum those to get the total tax bill. For instance, for a single person making $40,000 taxable income under the current tax structure calculate the tax on the first $27,050 of income at 15% and then the tax on the remaining income up to the $40,000 ($12,950) at 28%, for a total tax bill of $7,683--$4,057 at 15% and $3,626 at 28%. For a married couple making $60,000 under the current code the tax would be $10,924----, $6,780 tax on the first $45,200 at 15% and $4,144 tax on the next $14,800 of income at 28%.

Calculate the tax for a single filer under the current and proposed plans at the:

- just out of high school ($5000) level, _____
- the first good job ($25,000) level, and _____
- the successful career person ($70,000) level. _____

For a married couple:

- At the ($35,000) level. _____
- At the ($80,000) level. _____
- You might want to take this lesson home and how the proposed tax plan affects your family.

So, what do you think? Is Pres. Bush's tax proposal more or less progressive than the current plan, if we only take into account the change in tax rate categories? Be prepared to defend your position in a class discussion.

Look back at Bill Ahern's analysis of the tax code and his interesting observation that progressive taxes are really "autopilot" tax increases.

For some politicians, this must seem a dream come true - raising taxes without raising taxes! Can you explain to a friend how this works? Do you think it's fair, or would you take the opposite position that a tax increase should only happen as a result of a direct vote by the Congress? Be prepared to defend your answer in class discussion.

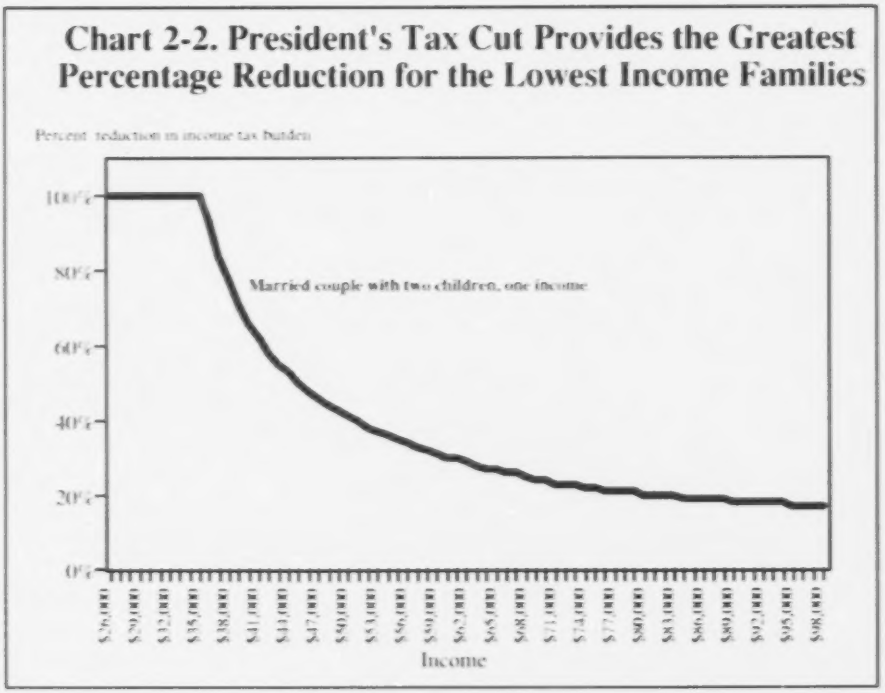
What's Fair?

Another concern in the tax debate can be most simply stated as: How do we fairly decide who pays how much? Again, the Tax Foundation sorts out the language we use to discuss "what's fair?"

The public is invariably surprised to learn that the top-earning 1 percent make 18 percent of the money and pay 34 percent of the income taxes. This large share of income earned and taxes paid

by the top 1 percent is nothing new, but over the past 20 years both percentages have slowly, steadily increased. Any reform other than an across-the-board tax cut, such as lowering the ceiling on the income a household can earn and still be required to pay only the lowest tax rates, increases the income tax's progressivity.

Keep Bill Ahern's analysis in mind, and examine the chart below, provided by the Whitehouse.



Answer the following questions with your discussion partners:

- Is it fair that the top earning 1 percent pay 34 percent of the income taxes?
- Is the claim by the Bush supporters in the title of the chart justified? How does the chart affect your evaluation of the tax proposal?
- Is a progressive tax structure "fair?" to the rich? to the poor? Explain your reasoning.

If you were going to propose a tax cut, would you cut all rates by the same percentage or would you cut different percentages for different income categories? Why?

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Highlights of the President's Tax Relief Plan from the Whitehouse Web Page.

- Replaces the current marginal income tax rates of 15, 28, 31, and 39.6 percent with a simplified rate structure of 10, 15, 25, and 33 percent
- Doubles the child tax credit to $1,000 per child.

Below are comments from the White House on the President's Tax Relief Plan and a link to his Executive summary.

The President's plan gives a tax cut to every American who pays income taxes—the typical family of four will be able to keep at least $1,600 more of their own money when the plan is fully effective. It increases tax fairness by giving the lowest income families the largest percent reduction. . . .

Rising Individual Tax Burdens

There is a great need for tax relief today. Total Federal revenues have surged as a share of Gross Domestic Product (GDP) since the mid-1990s. In fact, individual income taxes now take up the largest share of GDP on record—even above World War II levels. . . .

Recent gains in real wages account for roughly 20 percent of this individual income tax surge. Most of the individual tax code is indexed only for inflation. Thus, when wages gain in excess of inflation, taxpayers' effective tax rate rises. . . .

Rising tax burdens limit families' ability to dedicate resources to their most pressing concerns. This is unfortunate since families are the best stewards of their resources, and the best judges of their own needs. Some families need more for education, some need more for child care, some need more for other things entirely—things that no Government or bureaucrat can possibly predict. The wise choice is to put families, not bureaucrats, in charge of these decisions. The President's tax relief plan would do just that.

Providing Fair and Balanced Tax Relief

The President's tax plan provides relief for every income taxpayer; however, it gives the lowest income families the greatest percentage reduction. Indeed, higher income individuals will pay a higher share of income taxes after this plan takes effect. (See chart 2-2 above)

Does the analysis by the President's office seem to agree with the analysis of progressivity by Mr. Ahren and the Tax Foundation?

Class Discussion Questions:

- Is the Presidents' tax plan more progressive or less progressive than the current code?

- The White House summary states, " The President's tax plan provides relief for every income taxpayer; however, it gives the lowest income families the greatest percentage reduction. Indeed, higher income individuals will pay a higher share of income taxes after the plan takes effect." What is your opinion? Who gains the most under the proposed rates, the lower income families or the higher income families and individuals?

Here are links to Heartland where Bill Ahern's article appears as well as the Whitehouse, the Tax Foundation and Freedom Works the home page of the office of the House Majority Leader.

www.heartland.org
www.whitehouse.gov/news/usbudget/blueprint/bud02.html
www.taxfoundation.org
www.freedom.gov/taxcut

Answers for teacher reference:

- Is the Presidents' tax plan more progressive or less progressive than the current code? The President's tax plan is more progressive that the current structure, while it gives tax rate cuts to all income ranges, it gives the largest reductions to the lowest income brackets.

- The White House summary states, " The President's tax plan provides relief for every income taxpayer; however, it gives the lowest income families the greatest percentage reduction. Indeed, higher income individuals will pay a higher share of income taxes after the plan takes effect." What is your opinion? Who gains the most under the proposed rates, the lower income families or the higher income families and individuals? This question is open to some degree of opinion and should probably not be presented as though there is a clear correct answer. When any given individual or family is considered many other factors in the tax code, and some additional provisions such as the child tax credit come into play to impact the final tax liability.

Calculate the tax for a single filer under the current and proposed plans at the:

	Current	Proposed
• just out of high school ($5000) level,	$ 750	$ 500
• the first good job ($25,000) level, and	$ 3,750	$ 3,450
• the successful career person ($70,000) level.	$ 16,216	$14,494
For a married couple:		
• At the ($35,000) level.	$ 5,250	$ 4,650
• At the ($80,000) level.	$ 13,664	$12,380